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E.O. 11652: N/A

TAGS: ECON, IN

SUBJECT: INDIAN ECONOMY IN THE FIRST MONTHS OF THE EMERGENCY

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REF: (A) NEW DELHI 10770 (B) NEW DELHI 10733 (C) NEW DELHI 10400

SUMMARY: THIS REPORT, DRAWING ON REFTELS, PRESENTS AN OVERVIEW OF THE INDIAN ECONOMY AS IT APPEARS TO US TODAY AND HOW IT MAY MOVE IN THE NEAR TERM. THE GOI TARGETS OF 1975-76 NATIONAL INCOME AND INDUSTRIAL OUTPUT INCREASES OF 5-6 PERCENT ARE REALIZABLE. THE GOVERNMENTS' ECONOMIC "GAME PLAN" CALLS FOR AGRICULTURAL-LED GROWTH WHICH, IT IS HOPED, WILL HAVE BENEFICIAL MULTIPLIER EFFECTS ON THE REST OF THE ECONOMY. THE CURRENT MONSOON IS FAVORABLE (SO FAR) AND SHOULD LEAD TO A SUBSTANTIALLY BETTER KHARIF (FALL) CROP THAN THE DROUGHT-CURTAILED OUTPUT OF LAST YEAR. AT PRESENT NEW INVESTMENT IS VIRTUALLY NON-EXISTENT BECAUSE OF BUSINESS UNCERTAINTY AND SLACK DEMAND. WHOLESAL E PRICES, WHICH HAVE COME DOWN SUBSTANTIALLY FROM THEIR SEPTEMBER 1974 PEAK, APPEAR TO HAVE BOTTOMED OUT. INFLATION THIS YEAR MAY BE IN THE RANGE OF WHICH CAN BE COVERED BY NET INFLOWS OF FOREIGN ASSISTANCE, IS EXPECTED.

LITTLE OF THIS, GOOD OR BAD, HAS BEEN EFFECTED BY MRS. GANDHI'S 20 POINT PROGRAM WHICH HAS BEEN MOSTLY RHETORIC SO FAR. YET IN POLITICAL TERMS THE PRIME MINISTER WILL GET THE "CREDIT" FOR PROBABLY THE BEST ECONOMIC YEAR SINCE 1970-71, JUST AS SHE WOULD BE "BLAMED" IF THE ECONOMY TURNED SOUR. WHILE, ON BALANCE, THERE IS REASON TO BE CAUTIOUSLY OPTIMISTIC ABOUT BOTH THE INTERNAL AND EXTERNAL ASPECTS OF THE INDIAN ECONOMY IN THE SHORT RUN, WE DO NOT FORESEE RAPID ECONOMIC GROWTH OR BASIC SOLUTIONS TO DOMES-

TIC ECONOMIC OR BALANCE OF PAYMENTS PROBLEMS. END SUMMARY.

1. OVERALL ECONOMIC GROWTH: THE GOI HAS ANNOUNCED A GOAL OF A 5-6 PERCENT INCREASE IN NATIONAL INCOME THIS FISCAL YEAR. IF REACHED, THIS WOULD REPRESENT THE BEST INDIAN PERFORMANCE SINCE 1970-71. THE GOI ECONOMIC GAME PLAN COUNTS ON A SUCCESSFUL KHARIF HARVEST WHICH HOPEFULLY WILL HAVE MULTIPLIER EFFECTS ON THE REST OF THE ECONOMY BY INCREASING EFFECTIVE DEMAND. THE GOVERNMENT GROWTH TARGET APPEARS REALIZABLE TO US, ALTHOUGH AGRICULTURE MAY NOT PLAY AS PROMINENT A ROLE IN THE ECONOMIC UPSWING AS THE JCOI HOPES.

2. AGRICULTURE: THE IMPORTANCE OF THE AGRICULTURAL SECTOR AND WEATHER CANNOT BE OVERSTATED. (AGRICULTURE ACCOUNTS FOR APPROXIMATELY 40 PERCENT OF GDP). THE CURRENT MONSOON SEASON HAS BEEN FAVORABLE SO FAR, AND THE GOI IS PREDICTING A RECORD KHARIF CROP OF 69 TO 70 MILLION MT (ABOUT 2/3 OF IT RICE). WE ARE ESTIMATING A KHARIF HARVEST OF 63-69 MILLION MT (REF A), A CONSIDERABLE IMPROVEMENT OVER LAST YEAR. THE GOI TARGET OF TOTAL AGRICULTURAL OUTPUT THIS YEAR IS 114 MILLION MT; WE ARE TENTATIVELY FORECASTING OUTPUT IN THE RANGE OF 105-110 MILLION MT, WHICH WOULD BE A RECORD OR NEAR-RECORD COMBINATION OF KHARIF AND RABI (SPRING) HARVESTS IF THE UPPER END OF THE RANGE WERE ACHIEVED.

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3. INDUSTRY: AS OUTLINED IN REF B, INDUSTRIAL PRODUCTION IN THE PRIVATE SECTOR IS RATHER SLACK AT PRESENT BECAUSE OF BUSINESS UNCERTAINTY DUE NOT ONLY LACK OF EFFECTIVE CONSUMER DEMAND BUT ALSO TO THE CHANGED POLITICAL SITUATION. LITTLE OR NO NEW INVESTMENT IS OCCURRING. PRIZE CONSTRUCTION IS STAGNANT BOTH BECAUSE OF CONCERN OVER EXHIBITION OF "BLACK MONEY" IN NEW BUILDING AND UNCERTAINTY ABOUT URBAN LAND REFORM MEASURES WHICH MAY BE IN THE WIND. GOI ATTEMPTS TO IDENTIFY "NET WORTH" OF THE UPPER MIDDLE CLASS BY LARGE SCALE INCOME TAX SEARCHES OF PRIVATE HOUSES HAS CAUSED THE ENTREPRENEURIAL CLASS TO PULL BACK INTO A SHELL. ON THE OTHER HAND, PUBLIC SECTOR PRODUCTION IN SUCH AREAS AS STEEL, COAL, AND POWER IS UP SIGNIFICANTLY. THE RAIL SITUATION HAS IMPROVED MARKEDLY, LABOR PEACE PREVAILS, AND INCREASED SUPPLIES OF AGRICULTURAL RAW MATERIALS ARE GETTING TO FIRMS, IN CONTRAST TO PAST CHRONIC SHORTAGES OF MATERIALS AND SEMI-FINISHED PRODUCTS. DEMAND WILL HAVE TO BE STIMULATED IF INCREASED OUTPUT IS NOT TO LEAD TO NON-MARKETABLE SURPLUSES. THE GOI IS ESTIMATING A 5-6 PERCENT GROWTH IN INDUSTRIAL PRODUCTION IN IFY 1975-76 WITH EFFECTIVE DEMAND EXPECTED TO PICK UP IN SEVERAL MONTHS AT THE CONCLUSION OF THE KHARIF CROP AND THE BEGINNING OF THE "BUSY" ECONOMIC SEASON. FAIRLY AMBITIOUS TARGETS HAVE BEEN SET FOR A NUMBER OF INDUSTRIES. WE BELIEVE THAT THE GOVERNMENT'S OVERALL INDUSTRIAL GOAL CAN BE REACHED, IF BUSINESS CONFIDENCE REVIVES, THOUGH LOFTY PAPER "PLAN" TARGETS FOR MANY INDUSTRIES WILL CONTINUE TO BE UNMET AND IGNORED.

4. INFLATION: THE GOVERNMENT HAS BEEN VERY SUCCESSFUL IN COOLING INFLATIONARY PRESSURES IN THE PAST YEAR. THE OFFICIAL WHOLESAL PRICE INDEX, WHICH REACHED A PEAK LAST SEPTEMBER, HAS GENERALLY DECLINED SINCE THEN. BY END-JULY 1975 THE INDEX WAS 3 PERCENT LOWER THAN A YEAR BEFORE, ALTHOUGH IT NOW APPEARS THAT WHOLESAL LIMITED OFFICIAL USE
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PRICES HAVE BOTTOMED OUT. INFLATIONARY PRESSURES IN THE INDUSTRIAL SECTOR WILL PROBABLY INTENSIFY. THE GOVERNMENT IS LIKELY TO CONTINUE ITS CREDIT SQUEEZE EVEN THOUGH DEMAND FOR CREDIT IS NOW RELATIVELY LIGHT. THIS DOMINANT THEME (OR OBSESSION AS SEEN BY ITS CRITICS) IS DUE TO THE PRIME MINISTER'S ACCEPTANCE OF THE VIEWS OF SOME OF HER TECHNOCRATS THAT FAST ECONOMIC GROWTH IN INDIA IS IMPOSSIBLE DUE TO A VARIETY OF BOTTLENECKS, WHILE INFLATION IS ECONOMICALLY AND POLITICALLY DEBILITATING. ECONOMIC AUTHORITIES ARE HOPING THAT INCREASED REVENUES (LARGELY DUE TO MORE EFFICIENCY AND PRICE INCREASES IN THE PUBLIC SECTOR) LATER THIS YEAR WILL RESULT IN A LOWER CENTRAL GOVERNMENT BUDGET DEFICIT THAN IN IFY 1974-75. INFLATION IN INDIA THIS FISCAL YEAR MAY BE HELD TO THE 6-8 PERCENT RANGE, A VERY RESPECTABLE SHOWING COMPARED TO LAST YEAR'S PRICE INCREASE OF APPROXIMATELY 24 PERCENT, UNLESS, AS SOME ECONOMISTS FEAR, BOTTLENECKS IN THE ECONOMY GENERATES A NEW INFLATIONARY SPIRAL, AS INDUSTRIAL PRODUCTION INCREASES DUE TO DEMAND PULL ON SCARCE RAW MATERIALS AND TRANSPORT. THIS IS LIKELY TO BE A PERENNIAL PROBLEM UNLESS CAPACITY IS

INCREASED.

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5. 20 POINT PROGRAM: THE ECONOMIC-SOCIAL PROGRAM OUTLINED BY MRS. GANDHI IN LATE JUNE FOLLOWING THE PROCLAMATION OF EMERGENCY IS NOT NEW, EXCEPT IN A FEW MINOR INSTANCES. WHAT MAY HAVE CHANGED

IS GOVERNMENT DETERMINATION TO IMPLEMENT SOME OF THE REFORM MEASURES.
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SURES IN THE LIGHT OF A CHANGED POLITICAL SITUATION. THE CONVENTIONAL WISDOM, REINFORCED BY A CYNICISM DIFFICULT TO AVOID IN INDIA, IS THAT NOTHING WILL HAPPEN. HOWEVER, WE WOULD NOT EXCLUDE THE POSSIBILITY THAT THE PM, UNLIKE IN 1971, WILL REALLY TRY THIS TIME TO MAKE FUNDAMENTAL CHANGES IN THE ECONOMIC (AND, INEVITABLY, POLITICAL) SYSTEM. THE CONSEQUENCES OF SUCH AN ATTEMPT ARE UNCERTAIN BUT WOULD CERTAINLY BE DESTABILIZING IN THE MEDIUM TERM (E.G., DISRUPTION OF AGRICULTURAL PRODUCTION). IT IS MORE LIKELY, HOWEVER, THAT MRS. GANDHI WILL ONLY NIBBLE AT REFORM, WITH MEASURES LIKE REDISTRIBUTION OF SOME PUBLIC LANDS. ANY IMPLEMENTATION OF REFORMS IN SUCH POLITICALLY SENSITIVE AREAS AS LAND TENANCY AND RURAL CREDIT IS BOUND TO BE A LONG AND DIFFICULT PROCESS.

6. ASPECTS OF THE 20 POINT PROGRAM HAVE ALREADY HAD SOME IMPACT ON URBAN DWELLERS IN THE FORM OF GREATER LABOR DISCIPLINE/PRODUCTIVITY AND POSTED PRICES WHICH GIVE A BETTER GUARANTEE TO THE CONSUMER OF NOT BEING CHEATED. NEVERTHELESS, THE REFORM PROGRAM, EVEN IF CARRIED OUT UNDER THE BEST OF CIRCUMSTANCES, WOULD HAVE LITTLE EFFECT ON ECONOMIC PROSPECTS THIS YEAR. IN THE LONG RUN, HOWEVER, ANY SUCCESSFUL STRUCTURAL REFORM OF ECONOMIC AND SOCIAL INSTITUTIONS -- A VERY BIG "IF" -- WOULD BE BENEFICIAL FOR THE INDIAN ECONOMY.

7. EXTERNAL SECTOR: INDIA'S EXTERNAL PROSPECTS LOOK RELATIVELY GOOD THIS YEAR(REF C). GOI IS PUTTING TOP PRIORITY ON THE EXPANSION OF EXPORTS (SUCH AS SUGAR AND ENGINEERING GOODS). IT HAS SET A 1975-76 EXPORT TARGET OF APPROXIMATELY \$4.4 BILLION (10 PERCENT INCREASE IN VALUE OVER LAST YEAR). THIS GOAL MAY ALMOST BE MET. QUANTITIES OF MOST IMPORTS WILL PROBABLY REMAIN ABOUT THE SAME AS LAST YEAR. PRICE CHANGES ARE LIKELY TO BE LARGELY OFFSETTING, BUT TPV VALUE OF POL SHIPMENTS HERE WILL BE HIGHER. WE BELIEVE THAT IMPORTS MAY BE AROUND \$5.7 BILLION, RESULTING IN A BALANCE OF TRADE DEFICIT OF ALMOST \$1.5 BILLION. ON THE CAPITAL ACCOUNT, EXPECTED AID DISBURSEMENTS, INCLUDING DEBT RESCHEDULING, BY THE CONSORTIUM (WORLD BANK AND 'WESTERN' COUNTRIES), HELP FROM OPEC, AND THE USE OF THE IMF OIL FACILITY WILL PROBABLY JUST ABOUT COVER THE DEFICIT IN THE CURRENT ACCOUNT. THEREFORE, INDIA MAY DRAW DOWN LITTLE OF ITS INTERNATIONAL RESERVES IN FY 1975-76.

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8. IN CONCLUSION, THE BASIC POLITICAL/SECURITY CONCERNS PREVALENT IN THE INITIAL WEEKS AFTER THE EMERGENCY HAVE BEGUN TO GIVE WAY TO POCKETBOOK ISSUES, E.G., FOOD POLICIES. OUR APPRAISAL IS THAT A

GOOD MONSOON THIS YEAR WILL STRENGTHEN THE PRIME MINISTER'S POLITICAL POSITION, ALTHOUGH ANY ECONOMIC SUCCESS WILL HAVE LITTLE TO DO WITH HER "NEW" PROGRAM. WHILE WE DO NOT NOW FORESEE ANY BASIC SOLUTIONS TO THE INTERNAL AND EXTERNAL PROBLEMS FACING THE INDIAN ECONOMY, MRS. GANDHI, PROBABLY CAN LOOK FORWARD IN THE ECONOMIC AREA TO A PERIOD BETTER THAN ANY IN HER LAST 4 DIFFICULT YEARS. ANY THREAT TO THE PRIME MINISTER'S POSITION IN THE SHORT RUN WILL BE POLITICAL, RATHER THAN ECONOMIC, IN NATURE.
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